



Internal Audit Correspondence

Audit:	Cap Ex
Date:	6/17/02 Approx 3:35PM
Participants:	David Myers, Cynthia Cooper, Glyn Smith
Method of Communication:	Meeting in David Myers's office

Cynthia and Glyn went to David Myer's office and requested support for the prepaid capacity entries booked by Betty Vinson and Daniel Renfro. Glyn stated that IA was trying to get an understanding of the prepaid capacity entries and asked David if he could explain prepaid capacity. David asked Cynthia if she had had a conversation with Scott Sullivan on the issue and what the nature of that conversation was. Cynthia stated that Scott had said prepaid capacity was from zero and low utilized leased lines. David stated that the Company's cost structure has gotten too high. He stated that the field has been asked to lower the cost structure of the network and that Ron Beaumont has made a commitment to do this. David indicated that he didn't see how the current cost structure could be so high and that the Company could not continue with the cost structure at current levels. He added that if the structure does not change, the Company might as well shut the doors.

Cynthia asked David if he had support for the entries and David stated that he did not. David stated he could go back and construct support but that he was not going to do that. Glyn asked David how the amounts for the entries were derived. David stated the amounts were booked based on what they thought the margins should be. Cynthia asked David if there were any accounting standards for this type of treatment. David stated there were no specific accounting pronouncements supporting these entries. David also stated that they probably shouldn't have capitalized the line costs but once it was done the first time (2Q01) it was difficult to stop. David indicated that he has felt uncomfortable with these entries since the first time they were booked. Glyn asked David how this would be explained to the SEC and David stated he had hoped it would not have to be explained.

David asked where IA would go from here and Cynthia stated the audit would continue. David stated he would not ask IA to do anything less.

Glyn asked David if he was aware of other companies in the industry using the same treatment. David indicated that other companies had to be doing the same thing.

Cynthia asked David if there were any other entries that he felt uncomfortable with and David stated that these were the only ones. Cynthia told David that she and Glyn would get together with he and Scott Sullivan Tuesday morning to discuss further.



Internal Audit Correspondence

Audit:	Capex
Date:	June 17, 2002 7:00 PM
Participants:	Ferrell Malone, Cynthia Cooper and Glyn Smith
Method of Communication:	Meeting in the Audit Library

Cynthia Cooper and Glyn Smith met with Ferrell Malone to update him on the conversations with Betty Vinson, Buddy Yates, David Myers and Max Bobbitt that had occurred earlier in the day.

Cynthia and Glyn related the following events and conversations to Ferrell:

- First we went to Betty Vinson's office and requested support for the entries. Betty stated that she posted the prepaid capacity entries but did not know what prepaid capacity was and did not have support for the entries. She indicated that David and Buddy provided the amounts for the entries and that we should go to them for support.
- Next we went to Buddy Yates to request support for the entries. Buddy stated that he was not familiar with the entries and that we should talk to David Myers. Buddy indicated that he had not heard of prepaid capacity.
- Next we went to David Myers' office and requested support for the entries. David stated that he did not have support for the entries and that the amounts were booked based on what they thought the margins should be. David said that there were no accounting pronouncements to support these entries. David acknowledged that the line costs should probably not have been capitalized and stated that it was difficult to stop once started.

Cynthia told Ferrell that Max had been apprised of the discussion with David Myers, and that Max had requested that we update Ferrell. Ferrell stated that he would call Max Bobbitt and discuss the issue.

Internal Audit Correspondence

Audit:	Capex
Date:	6/24/02 Approximately 10:30AM
Participants:	Troy Normand, Cynthia Cooper, Glyn Smith
Method of Communication:	Meeting in 1A Conference Room

Troy Normand delivered the PP&E roll-forward schedules for 1Q01 to 4Q01, which had been requested earlier in the morning by Cynthia Cooper and Glyn Smith. Cynthia asked Troy to walk through the roll-forward schedules. Troy noted the first page of each roll-forward represented PP&E Cost and the second page represented PP&E Accumulated Depreciation. Cynthia requested Troy provide the 1Q02 Accumulated Depreciation roll-forward as the 1Q02 roll-forward given to Audit by Sanjeev Sethi only contained the PP&E cost portion. Troy stated he would provide Audit with the Accumulated Depreciation roll-forward for 1Q02.

Cynthia noted that there were significant amounts in the "Transfers" column and asked Troy what these amounts related to. Troy described the process by which all additions are placed in CIP until the asset is complete and ready for use. At this point, assets are transferred from CIP into the various PP&E accounts, including Software Development.

Cynthia asked Troy if there were any specific areas related to Cap Ex that should be included in Internal Audit's testing. Troy asked if we were referring to the "Additions" on the PP&E roll-forward and Cynthia stated we were interested in any areas related to Cap Ex that should be included in Audit testing. Cynthia asked Troy if the prepaid capacity entries were included in the "Additions" column of the PP&E. Troy indicated they were in the additions column but he was not sure what accounts were used.

Cynthia asked Troy if there were other entries besides the prepaid capacity entries that concerned him. Troy stated there were some over-accruals for line costs that the Company relieved periodically throughout 2000 that concerned him. He stated that he believed the reason line costs began being capitalized in 2001 is that there was no more room to further reduce the liability account. Troy stated that he believed the relief of the line cost liability account was aggressive accounting and contemplated resigning in 2000. He also stated that he believed the prepaid capacity entries were wrong and beyond aggressive accounting.

Troy stated that he was concerned regarding the relief of line cost accruals and prepaid capacity and that:

- He went to Scott Sullivan at the end of 3Q00 to express his concerns related to relieving line cost accruals. He stated that Scott explained the business reasons behind the entries, explained that some things were occurring to bring the cost structure down, and assured him that everything would be OK. Troy indicated that he did not know enough to refute Scott's explanation.
- He expressed his concerns regarding prepaid capacity to David Myers in 2001 and also stated that Betty Vinson and Buddy Yates had also expressed concern over the prepaid capacity entries.

AV-11

- After Scott Sullivan's guidance given in April 2002, Troy believed the guidance had been based on 1Q02 numbers and that the only way to meet this guidance was to continue booking the prepaid capacity entries. He communicated to David that he was uncomfortable enough to resign and that since he did not yet have another job he would like a RIF package with his last date of employment being 5/31/02.
- He stated that David indicated that he was working with Scott, the head of HR, and Mike Salsbury on a RIF package.
- On 5/31/02, he was told that nothing had been finalized related to his package and that management would like for him to come back to work after his vacation the first week of June.
- He did not communicate his concerns regarding prepaid capacity or relieving line cost accruals to external or internal audit because he was concerned for his job and has a family to support. He stated that in hindsight he wished that he had notified external or internal audit.

Cynthia asked Troy if there were any other areas outside of these issues he felt uncomfortable with. Troy stated that while there were some judgmental areas of accounting, these were the only areas that concerned him. Cynthia noted that there were some debit balances in some of the reserve accounts. Troy stated that he was comfortable with the overall reserves and that one can't look at the reserve on an individual account basis.

AV-11

Confidential Treatment
Requested by WorldCom

1COEC1:
000318

F 1/2

Cooper, Cynthia

From: Woods, Lucy

Sent: Wednesday, June 26, 2002 1:51 PM

To: Cooper, Cynthia

Subject: In Confidence

Cynthia

You need to see this. I asked all the EMEA financial accountants to tell me if they knew of any postings in EMEA which they considered irregular over the past few years. This resulted in the attached mail. I have copied it to Ed Tagg.

regards

Lucy

-----Original Message-----

From: Brabbs, Steven

Sent: 26 June 2002 15:44

To: Woods, Lucy

Subject: related issue

Lucy,

As per our conversation, please find my note attached below.

Regards, Steven

<<Note to Lucy re Line cost entry in 2000.doc>>

06/26/2002

Confidential Treatment
Requested by WorldCom

AV-11

1COEC1:
000480

Lucy:

In light of the most serious news that broke yesterday in the US, I would like to bring the following matter to your attention.

The amount involved is much lower, although certainly sufficiently large to warrant this note, and appears directly related in nature to the accounting irregularities disclosed in the media today.

In March of 2000, I was Director, International Finance & Control. My responsibilities at the time included the provision of information to management on the consolidated management accounting numbers for Europe and Asia.

After we had closed our books and reported our Q1 2000 numbers to the US, a journal entry was made by persons in the US at the consolidated level which favourably impacted our reported figures. We had no control over that entry, the effect of which was to reduce our line costs by \$33,600,000.

We were not informed about the journal adjustment, we only discovered it when we retrieved our figures from one day to the next and could not understand why the gross margin had moved. After phone calls and emails to the US, we were told that the entry had been made on the basis of a directive from Scott Sullivan. Despite repeated requests, we were given no support or explanation for the entry.

During April 2000, I reviewed at a high level the International Q1 results with the UK audit partner and senior manager. The increase in our margin trend due to the above entry was obvious and I explained that this was an entry made in the US, and that the auditors should request follow through in the US to ensure appropriate accounting treatment was in place at the global consolidated level. A relevant paragraph was included in their report that was sent to both Andersens and senior WorldCom finance management in the US.

Shortly after, I received an email from David Myers indicating he was not pleased this matter had been raised with Andersens without his knowledge. I responded indicating that I had not said the entry was incorrect, only that we had no support for it in International, and that it was appropriate therefore to request justification (or alternatively a corresponding and reversing entry) from the US.

During Q2 US senior finance mgmt indicated they would like to "push down" the above consolidation entry and we were asked to book a journal in our own accounting records in International. Since I had no supporting documentation for the journal, I initially refused to record it.

However, pressure was exerted and we were *instructed* to make the entry (this pressure we understood was from Scott's office specifically). Still uncomfortable, I said that I would not under any circumstances book the journal into one of our legal accounting company books and records. What we agreed to do was to create a "management company" (NOT a legal entity) and post it there. This had the effect of maintaining the management accounting reported figures, but I was making it clear that I did not see it as a journal that I could support from a legal or US or local accounting perspective. This entry was made on 10 July 2000. The narrative reads "late adj as instructed by Scott Sullivan". It remains there today.

As we moved through 2000, I continued to raise the subject by phone and I believe on at least two occasions by email. However the US senior finance mgmt were reluctant to discuss it, and simply continued to refer back to the fact that the entry had been made at Scott Sullivan's direct instruction. My concern remained, but felt my only option was to make it absolutely clear that we did not see it as a stand-alone, supportable transaction in our International books. It remains outside of any legal entity and I repeatedly indicated that the US team needed to ensure that at a global consolidated level, they were comfortable that appropriate accounting treatment had been observed. I still do not know how this has been handled in the US.

If the US cannot justify this journal, and if they do not have any corresponding reversal in their consolidation journals, then I believe it is possible that our current consolidated global balance sheet has an unsupported debit amount of \$33.6m in respect of this item.

I hope this lays out clearly the sequence of events. If you need further information or clarification, obviously I remain available to provide that.

Regards, Steven Brabbs
26 June 2002

**MINUTES OF THE
REGULAR MEETING OF THE AUDIT COMMITTEE
OF THE BOARD OF DIRECTORS OF WORLDCOM, INC.
March 6, 2002**

A Regular Meeting of the Audit Committee of the Board of Directors of WorldCom, Inc. (the "Company") was held on Wednesday, March 6, 2002 at 4:00 p.m. (EST) at the WorldCom office located at 1133 19th St NW in Washington, conference room # 1204.

Mr. Max Bobbitt, Chairman of the Audit Committee, called the meeting to order.

Members Present

Audit Committee: Mr. Max Bobbitt, Mr. Francesco Galesi, and Mr. Jim Allen were present. Ms. Judith Areen joined the meeting via conference.

Andersen: Mr. Melvin Dick and Mr. Kenny Avery were present.

WorldCom: Mr. Scott Sullivan and Ms. Cynthia Cooper were present. Ms. Stephanie Scott joined the meeting via conference.

Minutes Approved

Mr. Bobbitt asked if there were any changes to the September 10, 2001 or February 6, 2002 minutes. Mr. Jim Allen noted one correction to the minutes. Mr. Bobbitt stated that pending that correction, the minutes would be approved as submitted. A motion was made and accepted to approve the revised minutes.

Mr. Sullivan stated that Ms. Scott would discuss the 10-K draft previously provided to them. Ms. Scott asked if there were any comments related to the 10-K draft. Mr. Bobbitt stated that the Company's security interest in the collateral supporting the CEO loan would be perfected in 30 days. Ms. Areen inquired whether an 8-K would be required and whether the Audit Committee should make its motion to the Board subject to any new information arising from the ongoing review of the CEO loan.

After a discussion period, Mr. Bobbitt made a motion that the Audit Committee recommend to the Board of Directors that the audited financial statements be included in the Company's annual report on Form 10-K for the year ended December 31, 2001, to be filed with the Securities and Exchange Commission. The motion was unanimously approved.

Ms. Scott excused herself from the remainder of the Audit Committee Meeting after concluding discussion of her agenda items.

Mr. Bobbitt asked Mr. Avery to discuss any Andersen items on the agenda.

Confidential Treatment
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Andersen Discussion Items

Mr. Avery discussed items in the Andersen presentation – Audit Committee Quality of Earnings Discussion, Year Ended December 31, 2001 as follows:

- Mr. Avery noted that pursuant to existing rules and the Committee's charter – Committee

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members are required to discuss the quality, not just acceptability, of the Company's accounting principles and underlying estimates in the financial statements. To assist the Committee members with this requirement, Andersen has developed a framework to facilitate discussion.

- Mr. Avery discussed issues, which the Audit Committee should consider related to substance, verifiability, clarity, consistency, comparability, earnings persistence, and disaggregated information. See issues detailed in the March 6, 2002 Audit Committee Package.

Mr. Jim Allen stated that the members of the Audit Committee had to rely on Andersen and Management to provide them with relevant information.

Ms. Judith Areen stated that she had a copy of the questions that Warren Buffet recently suggested Audit Committee Members ask the Company's public accountants. Ms. Areen asked if Andersen were solely responsible for preparing the company's financial statements would they be prepared in the same manner selected by Management. Mr. Avery responded yes.

Mr. Allen stated that he had asked Mr. Avery a question in the prior Audit Committee Meeting related to debt covenants and did not feel comfortable that Andersen had completed the debt covenant work based on the answer that Mr. Avery provided. Mr. Dick stated that the debt covenant work had been completed and that the Company was in compliance with all covenants.

Mr. Bobbitt then asked Ms. Cooper to discuss the Internal Audit items outlined in the agenda.

Internal Audit Discussion Items

First,

Staffing Changes:

- Ms. Cooper presented an organization chart and discussed staffing changes and stated that one auditor had recently resigned to accept another position and that at least two additional employees would be severed with the upcoming reduction in force.
- Mr. Jim Allen asked if the Company should consider increasing the audit staff. Mr. Sullivan stated that the Finance organization was not included in the previous severance since his organization had not grown, but that Finance would be impacted with the upcoming severance.
- Mr. Sullivan indicated that Mr. Ebberts had proposed a 50% reduction in internal audit compensation expense but that the final decision was to limit the reduction to 10%. He indicated that preparation of the Executive Report as well as the Commissions Audit is consuming significant audit resources. Ms. Cooper stated that moving the preparation of the Executive Report into Ron Beaumont's organization would allow four persons who are dedicated part time to completion of the report to work full time on audit.
- Mr. Sullivan asked if Mr. Ebberts would be comfortable with moving the report. Ms. Cooper indicated that Mr. Ebberts stated that he was comfortable with moving the report as long as he continued to receive the same level of reporting monthly.
- Mr. Bobbitt asked Ms. Cooper to work with Mr. Beaumont to migrate report preparation by April 1st.

2002 Proposed Internal Audit Plan: Ms. Cooper stated that:

- She was submitting the 2002 Proposed Internal Audit Plan (Plan) for Audit Committee approval.
- Internal Audit solicited feedback from Senior and Executive Management across the Company in developing the Plan, and Mr. Sullivan and Mr. Ebberts had reviewed and approved the Plan.
- The Plan may change during the year based on new areas of risk identified and special requests from Executive Management.
- The time required to complete the Commissions audit, migrate the Executive Report compilation to Ron Beaumont's organization, and special requests from Executive Management will impact completion of the 2002 Plan.
- As in prior years, the scope of internal audit work focuses heavily on operational effectiveness and efficiency, systems and internal controls.
- There are a significant number of follow-up audits included in the Plan intended to help ensure that key recommendations are implemented.

Ms. Cooper asked whether Andersen or the Audit Committee proposed any changes to the scope of internal audit work or the audits listed on the 2002 Plan. No changes were proposed and Mr. Bobbitt stated that the 2002 Plan was approved as submitted.

2001 Audits Completed: Ms. Cooper stated that 37 projects have been completed since January 1, 2001. The number of audits completed has decreased due to resources focused on the Commissions audit.

Executive Summaries for Key Audit Reports: Ms. Cooper reviewed the summary of key issues and recommendations outlined in section 5 of the March 6, 2002 Audit Committee Binder, and stated that copies of the full audit reports are available.

Ms. Cooper discussed Internal Audit's work in the following areas: Commissions, Web Hosting Revenue Integrity, Switch Access, EDS IT Outsourcing, Wireless General Controls, Domestic Line Cost, Capital Spending, Executive Report, International - Revenue Realization, International - Asia Pac Fraud Investigation, and International - Switched Voice Payment and Dispute Process.

Commissions: Ms. Cooper discussed the key issues and recommendations outlined in the Audit Committee Binder related to Commissions including the key causes and circumstances surrounding each commission overpayment, and stated that:

- She was updating them on the commissions fraud audit work that was reported on in the September 10, 2001 Audit Committee meeting.
- Since the Wall Street Journal article, Internal Audit has received numerous calls and letters alleging sales employee fraud and is in the process of investigating.
- Audit has identified key internal controls related to systems, processes and procedures that should be implemented to prevent future occurrences of sales employee fraud and commission

overpayments.

- Audit is holding meetings with various groups across the Company to help facilitate implementation of the key internal controls identified. Several key controls have already been implemented. Examples include migrating to a single commission system and implementing system controls to disallow payment on non-majors revenue location codes.
- Testing and quantifications are still in progress and will be reported at the next Audit Committee meeting. A significant portion of the overpayments has never been paid out and is fully recoverable from sales employee banks since commissions are capped each month.
- Some of the commission overpayments identified were driven by Sales employee fraud while other commission overpayments were a result of missing internal controls or system deficiencies.
- Of the accounts associated with commission overpayments, the only account that had a known revenue impact was OMNI. Two OMNI circuits were closed to billing and billed approximately \$14 million over 10 months. The circuits were subsequently cancelled. The revenue impact was a timing issue as the full \$14 million was credited.

Mr. Jim Allen asked if the Company had given any thought to rethinking the commission plans and methods/reasons for payment. Mr. Sullivan stated that Ron Beaumont was working to simplify and consolidate many of the plans and that commission payments will be dramatically reduced in 2002.

Mr. Bobbit excused himself from the Audit Committee Meeting to attend another Committee meeting.

Wireless General Controls: Ms. Cooper discussed the issues and recommendations outlined in the Audit Committee Binder and stated that:

- This review is the second of two audits completed in Wireless. The first audit released in May 2001 discussed the significant delays in customer billing and number of customer calls to Customer Service which were blocked and delayed. Ms. Cooper stated that Jon Stupka indicates the billing is now current, however there are still problems with blocked and delayed customer calls.
- The Wireless audit focused on reviewing the adequacy of systems and operational internal controls to minimize subscription fraud and no pay customers impeding collectibility. Controls supporting wireless order activation are not adequate and should be strengthened as quickly as possible to reduce intake of fraudulent and no pay customers. Delayed billing, subscription fraud and lack of key controls within Wireless have impacted collectibility.
- Network Services reporting to Ron Beaumont and Wireless Operations Review Staff reporting to Mr. Stupka have performed detailed testing which indicates bad debt losses due to delayed billing, inadequate controls, and direct sales channel subscription fraud.
- Mr. Stupka's testing focuses primarily on no pay customers. Network Services testing focuses on subscription fraud. The group has reported significant direct sales subscription fraud based on testing incoming orders for the Dallas Center and individual cases that they have investigated.
- Network Services coordinates with Legal and Human Resources to investigate reported cases of suspected wireless subscription fraud. Their testing resulted in 72 terminations and four

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prosecutions in 2000 and 15 terminations and three prosecutions in 2001.

- Sales rep misrepresentation and subscription fraud relating to the following have resulted in terminations and prosecutions: accounts set up with stolen identities (person billed for cellular service that someone else is using), stolen equipment, credit bypasses, second and third lines credit approved for a legitimate customer are activated for a non-legitimate customer (three phone credit approval policy).

Ms. Cooper noted that Mr. Stupka provided the written status included in the Audit Committee Package and that several key points everyone should review include:

- The accounts receivable balance and increased accounts receivable exposure due to delayed billing, subscription fraud and no pay customers
- Charts related to credits, fraud, accounts receivable and bad debt
- Ms. Cooper stated that Mr. Stupka indicates that while he has implemented some key controls outlined in the status, there is still a great deal of work to be done; and that as controls improve, Management will have visibility into the true profitability of the unit

Mr. Jim Allen asked Mr. Sullivan whether or not the Company had compared operating efficiency to other carriers. Mr. Sullivan stated that Wireless is one of the most significant problem areas for the Company today and that the Company should not be in the business. Mr. Sullivan stated that the margins are tight. Ms. Cooper stated that Mr. Stupka's analysis shows a 5% industry margin assuming that a Company bills accurately and timely and has strong collection efforts.

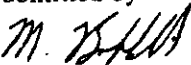
Next,

Ms. Judith Areen asked that Andersen be excused from the meeting so that the Audit Committee could have a discussion with Management. Mr. Melvin Dick and Mr. Kenny Avery excused themselves.

Mr. Francesco Galesi, Ms. Judith Areen, Mr. Jim Allen, Mr. Scott Sullivan and Ms. Cynthia Cooper continued with discussions.

The meeting was adjourned at approximately 5:00 p.m. (EST) on this the 6th day of March 2002.

Submitted by:



Max E. Bobbitt
Chairman

Confidential Treatment
Requested by WorldCom

From: Sullivan, Scott
Sent: Tuesday, March 06, 2001 1:49 PM
To: Myers, David
Subject: Re: FW: Telco

Well the numbers are in your attached spreadsheet and he needs to get to work now

Scott Sullivan

-----Original Message-----

From: Myers, David <david.myers@wcom.com>
To: Sullivan, Scott <Scott.Sullivan@wcom.com>
Sent: Tue Mar 06 11:38:03 2001
Subject: FW: Telco

-----Original Message-----

From: Bosley, Tom
Sent: Tuesday, March 06, 2001 11:37 AM
To: Myers, David
Cc: Prestwood, Louis
Subject: RE: Telco

Actually I asked Scott what numbers he wanted and I would see what could be done to get them. But... obviously gross margin is very important and we will put several projects in place to get this moving back where it was. The first quarter is pretty well cast at this point but we will define what we can do to reverse the trend.

-----Original Message-----

From: Myers, David
Sent: Monday, March 05, 2001 5:24 PM
To: Bosley, Tom
Cc: Sullivan, Scott
Subject: Telco

Tom,

Pls see the attached Gross Margin analysis which highlights the need for immediate attention to Telco and Margins.

Scott relayed a conversation you had with him at dinner when your volunteered to do whatever necessary to get Telco/Margins back in line. This was a dinner with Scott, Ron amd Bernie prior to the announcement of our last quarter.

As you can see, margins have declined significantly and your immediate attention is appreciated. We need to address this during the quarter and not at the end of the quarter. Just so you know, I fully realize the impact that declining pricing to our customers has had on margins but I hope you feel like me that it is impossible to accept declining margins given the significant capex (over \$16 billion over the past 2 years), access reform and the fastest growing part of our business being Telecom (more capex with lower variable line cost).

C

<< File: 2001 January Gross Margin Analysis vs Q1'00.xls >>

From: Yates, Buford
Sent: Tuesday, July 25, 2000 9:44 AM
To: Myers, David
Subject: RE: taxes

David,

I might be narrow minded, but I can't see a logical path for capitalizing excess capacity.

Your thoughts?

BY

-----Original Message-----

From: Minert, Tony
Sent: Tuesday, July 25, 2000 8:23 AM
To: Myers, David; Yates, Buford
Subject: FW: taxes

David,

Bill McGrath is in Australia right now, so we have been communicating by voice-mail and e-mail.

Below is an explanation of one of the reasons why we are so under utilized and something that I think you could go to Ron with.

What I don't understand is why they need such a redundant network. If they are ordering Sonet rings then there is redundancy built into them, so if he has additional rings that is two times the redundant. I don't completely understand how this works. I will get with the network folks here in Tulsa to try and find out.

I have asked Bill if he could come up with a dollar amount for the protect capacity.

Also, can we capitalize these cost?

Tony Minert

-----Original Message-----

From: Bill McGrath [mailto:bmcgrath@uu.net]
Sent: Monday, July 24, 2000 6:42 PM
To: tony.minert@wcom.com
Subject: RE: taxes

Tony,

I received you message on capitalizing costs related to capacity built for future needs.

I think you will find that hard to identify. You would be better served working on how to capitalize our protect capacity. We currently run a one for one protect scheme at UUNET. That equates into roughly half our capacity sits idle all the time. If we could capitalize that piece and draw down against it like a spare parts inventory, we would make the income statement look great.

I would approach it that the protect circuits hold a total inventory of mega bits. When we have an outage and consume megabits, we would draw down against the inventory. As we go to less and less protect with optical switching, we would remove most if not all the inventory.

Let me know what you think.

At 02:14 PM 7/24/00 -0500, you wrote:

>What is our tax rate for federal and state (average).

>

>Tony Minert

>

>-----Original Message-----

>From: ebedell@UU.NET [mailto:ebedell@UU.NET]

>Sent: Wednesday, July 19, 2000 1:15 PM

>To: tony.minert@wcom.com

>Cc: harbaugh@UU.NET; bmcgrath@UU.NET; jrocha@UU.NET; blem@UU.NET

>Subject: Re: taxes

>

>

>Tony,

>As an ISP UUNET pays both federal and state taxes on it's network cost

>(circuits and equipment). In instances were UUNET is a reseller, we might

>be exempted from paying taxes but this would be a Joan Caminos question.

>Joan manages the billing department.

>

>

>Thanks

>Eugene

>

>

>At 08:10 AM 7/19/00 -0500, you wrote:

>>Eugene,

>>

>>Do you guys pay taxes on your network cost or are you treated like an IXC

>>reseller and get this waived?

>>

>>Tony Minert

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C

From: Yates, Buford
Sent: Tuesday, July 25, 2000 9:53 AM
To: Minert, Tony; Myers, David
Subject: RE: taxes

Tony,

David and I have reviewed and discussed your logic of capitalizing excess capacity and can find no support within the current accounting guidelines that would allow for this accounting treatment. I think our efforts should shift back to our gross margin analysis and the g/l and essbase structural changes needed to support this analysis.

Thanks
BY

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>

>

>Thanks

>Eugene

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>At 08:10 AM 7/19/00 -0500, you wrote:

>>Eugene,

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>>Do you guys pay taxes on your network cost or are you treated like an IXC

>>reseller and get this waived?

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>>Tony Minert

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From: Minert, Tony
Sent: Wednesday, July 19, 2000 11:41 AM
To: Myers, David; Scott, Stephanie; Yates, Buford; Vinson, Betty; Willson, Mark
Subject: utilization of the domestic network

I talked to some people in the NIM organization about the utilization of the domestic network and here is what I have found out.

First of all we are signing up for term commitments. In most cases this is a five year term.

Stephanie - You asked the question about whether or not we would get our money back if we did not use all the capacity like I did with the AT&T swap four years ago. The answer to this is no. However, I hope that we could still explore ways to either take the unutilized network as an asset (Inventory, prepaid) or better yet, capitalize the cost.

We are currently running at a Utilization rate of about 85% to 87% from the serving wire center to the end office. Mona Abutaleb (Lynn Refer's replacement) has mandated that the utilization rate decrease to 75% so that we do not block any revenue. (Note - all of this is with the LEC's. It does not include any IXC charges.) I am being told that this will give us an additional 3 months worth of capacity. Meaning that if we stopped turning up any network that it would take three months to be at 100% capacity. That is a lot of line cost expense that does not have matching revenue today.

We are also changing our capacity from our POP to our serving wire center. We are turning up entrance facilities currently at the OC48 level instead of a DS3 at a time, however very soon this will increase to OC192 (I can remember when we turned up DS1's for entrance facilities). They are looking at this with a breakeven point of 24 months. Basically, if they could break even by ordering an OC192 or an OC48 within 24 months over ordering up DS3's then they are ordering up the service. This is going to mean that we have a lot of extra capacity, especially when we go to OC192's. The utilization rates on these nodes can also be measured. This is currently at 75% and will be greatly reduced once we move to OC192's. The good news is that we will need less capacity in the future and can grow into our network, the bad news is that the cost are going to be high in the first year, especially the first three to six months. Again, in my eyes, we are not properly matching up expense with revenue.

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Currently Access cost are \$200 million per month for the domestic network.
Some of this is local loop cost and switched network cost which do not fit into this equation. I am assuming that we could at least go back to January when estimating what the monthly cost impact would be.

This also does not include the UUNET network or what potential we have internationally. I have heard that the international network has a lot of excess capacity, but I have no idea if this is true or not.

My question is, can we pursue this? Should I get the line cost people involved to see what type of impact this might make on our line cost numbers or am I running into a dead-end because of the fact that this is not something that we could get reimbursed for if we don't use the capacity. Of course, I don't think there is any fear that we won't use the capacity. The network is growing so fast that they are having a hard time keeping up with the capacity needs.

Can you use the same argument that you use with installation. Since we don't recover the cost of unused capacity, can we capitalize this cost? Once revenue is recognized we start recognizing this as line cost expense, but until then we could then spread the three months worth of expense over the useful life of our customers or the circuit.

I can't imagine that there isn't something we can do. The impact could be huge. Like I said, if I was a book store or a computer store, I would not have to recognize any expense until I actually sold the product. In my eyes this is the same thing or at least it has similarities. There is no reason why I should have to recognize any expense until I sell the product. Of course this would make it an inventory or a prepaid which would not have the benefits of capitalizing the cost.

I am still trying to get with the internet folks to discuss this with them.

Tony Minert

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